

Message Text

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EXDIS/FOR RICHARD COOPER ONLY FROM FRANK

E.O. 11652: GDS

TAGS: ETRD

SUBJECT: CONSUMER IMPACT STATEMENT ON SUGAR

1. BELOW IS THE TEXT OF AN ANALYTICAL PAPER DONE BY TODD MINNIES AND ME FOR JOAN BRADEN ON THE EFFECT ON THE CONSUMER OF PROTECTION FOR U.S. SUGAR PRODUCERS.
2. I HAVE A VERY HARD TIME FINDING ANY DECENT PUBLIC POLICY ARGUMENTS IN FAVOR OF TARIFFS OR QUOTAS ON SUGAR, AND EVEN FOR DEFICIENCY PAYMENTS. THE CONSUMER AND FOREIGN POLICY ARGUMENTS AGAINST TARIFFS AND QUOTAS ARE PERSUASIVE. I WONDER WHETHER PRESIDENT CARTER COULD NOT BE PERSUADED WHEN AND IF THE CRUNCH COMES.
3. PERSONALLY, I WOULD FAVOR A POLICY ALONG THE FOLLOWING LINES:

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-- SOME DEFICIENCY PAYMENTS FOR A YEAR OR TWO BUT PHASED OUT OVER TIME TO ENCOURAGE HIGH COST PRODUCERS TO LEAVE THE INDUSTRY (PAYMENTS IN THE FIRST YEAR MIGHT BE EQUIVALENT TO A CENT AND A HALF A POUND, ABOUT \$200 MILLION).

-- ADJUSTMENT ASSISTANCE FOR BOTH WORKERS AND PRODUCERS (IS POSSIBLE BY PRESIDENTIAL DIRECTIVE IF ITC COMES UP WITH AN INJURY FINDING).

-- NEGOTIATION OF AN INTERNATIONAL AGREEMENT THAT FOCUSES ON PRODUCER RETENTION STOCKS RATHER THAN EXPORT QUOTAS AND PRODUCTION CONTROLS AS A MEANS OF PRICE STABILIZATION.

4. BEGIN TEXT: THE EFFECT ON CONSUMERS OF ACTIONS TO PROTECT UNITED STATES SUGAR PRODUCERS

5. IN THE CURRENT DISCUSSION OF PROTECTION FOR UNITED STATES SUGAR PRODUCERS, FIVE BASIC OPTIONS MIGHT BE CONSIDERED:

-- TARIFFS ON SUGAR IMPORTS,
-- QUOTAS ON SUGAR IMPORTS,
-- DEFICIENCY PAYMENTS UNDER THE AUTHORITY OF THE 1945 AGRICULTURAL ASSISTANCE ACT,
-- ADJUSTMENT ASSISTANCE, IF THE INTERNATIONAL TRADE COMMISSION (ITC) REPORTS A FINDING OF INJURY UNDER THE TRADE ACT OF 1974,
-- GOVERNMENT SUBSIDIES OR LOAN PROGRAMS TO ENCOURAGE INCREASED HOLDINGS OF SUGAR STOCKS.

6. IN THIS PAPER, WE ANALYZE THE IMPACT ON CONSUMERS OF THESE POLICY OPTIONS.

7. TARIFFS OR QUOTAS WOULD BOTH HAVE THE EFFECT OF INCREASING THE DOMESTIC PRICE OF SUGAR AND LOWERING OF CONFIDENTIAL

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THE INTERNATIONAL PRICE OF SUGAR. THEY WOULD BOTH ENCOURAGE EXPANSION OF HIGH COST UNITED STATES SUGAR PRODUCTION AND REDUCTION OF LOW-COST FOREIGN PRODUCTION. THEY BOTH ENCOURAGE MORE RAPID SUBSTITUTION OF HIGH-FRUCTOSE CORN SYRUP FOR CANE AND BEET SUGAR. THEY BOTH ENCOURAGE INCREASED U.S. SUPPLIES OF SUGAR, REDUCED U.S. DEMAND, A REDUCTION IN U.S. IMPORT DEMAND, AND A BUILDUP IN U.S. SUGAR STOCKS. IN OTHER WORDS, U.S. PROTECTIVE MEASURES WOULD REDUCE THE EFFICIENCY OF WORLD SUGAR MARKETS. FOREIGN PRODUCERS AND DOMESTIC CONSUMERS PAY FOR THIS INEFFICIENCY WHILE FOREIGN CONSUMERS AND DOMESTIC PRODUCERS RECEIVE BENEFITS, BUT NOT ENOUGH TO COUNTER-BALANCE THE COSTS TO OTHERS.

8. BOTH QUOTAS AND TARIFFS INVOLVE HIGHER SHORT-RUN COSTS TO THE CONSUMER IN THE FORM OF HIGHER SUGAR PRICES. THE CONSUMER ALREADY IS PAYING A PRICE FOR PROTECTIVE MEASURES. U.S. SUGAR IMPORTS ARE SUBJECT TO A TARIFF OF 1.875 CENTS PER POUND. PART OF THIS TARIFF IS, OF COURSE, BORNE BY FOREIGN PRODUCERS WHO RECEIVE LOWER PRICES FOR SUGAR SOLD INTERNATIONALLY. PART OF THE TARIFF RESULTS IN HIGHER U.S. DOMESTIC PRICES THAN WOULD PREVAIL IN THE ABSENCE OF THE TARIFF. BASED ON CURRENT ESTIMATES OF THE ELASTICITY OF DEMAND AND SUPPLY, THE

PRICE OF SUGAR IS RAISED DOMESTICALLY BY ONE CENT (?)BY
THE TARIFF. THE COST TO CONSUMERS OF THE ONE CENT IN
PRICE IS ABOUT 220 MILLION DOLS (?) PER YEAR.

9. IN THE THREE OPTIONS PUT FORWARD BY THE DEPARTMENT
OF AGRICULTURE AT THE MEETING OF THE ECONOMIC POLICY
GROUP ON MARCH 1, THE DOMESTIC PRICE OF SUGAR WAS TO BE
RAISED FROM ONE TO THREE CENTS PER POUND, BY QUOTAS IF
POSSIBLE. THE COST TO CONSUMERS OF THESE OPTIONS WOULD
RANGE FROM 220 MILLION DOLS TO 660 MILLION DOLS PER YEAR
IF QUOTAS WERE USED TO RAISE THE DOMESTIC PRICE. IN
OPTION C, THE MOST EXTREME OPTION, THE TOTAL COST TO
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CONSUMERS WOULD BE ABOUT 880 MILLION DOLS (?) PER YEAR,
INCLUDING THE COST OF THE EXISTING TARIFF.

10. IT CAN BE ARGUED THAT ALTHOUGH THE CONSUMER MIGHT
PAY SHORT-RUN COSTS FOR A HIGHER PRICE OF SUGAR, IN
THE LONGER RUN, THE CONSUMER WILL BENEFIT FROM PRICE
SUPPORTS IN A DEPRESSED MARKET. PRICE SUPPORTS NOW MAY
AVOID SHORT-SUPPLIES AND MUCH HIGHER PRICES IN THE EARLY
1980S.

11. THE VALIDITY OF THIS ARGUMENT IS HIGHLY QUESTIONABLE.
SUGAR CANE HAS A 12 TO 18 MONTH PLANTING CYCLE IN THE
UNITED STATES AND BEET SUGAR IS AN ANNUAL CROP. IT
WOULD BE QUITE EASY TO STIMULATE FURTHER PRODUCTION
WITHIN A YEAR'S TIME. INDEED AN ELASTIC RESPONSE IS
PART OF THE EXPLANATION OF THE LOW PRICE OF SUGAR TODAY.
OVER-EXPANSION TOOK PLACE AFTER A BRIEF PERIOD OF VERY
HIGH PRICES. FURTHERMORE, IF CURRENT PRICES ARE RAISED
VERY MUCH, HIGH FRUCTOSE CORN SYRUP MAY INCREASE ITS
MARKET SHARE MUCH FASTER AND WE COULD HAVE AN OVER
SUPPLY SITUATION INTO THE EIGHTIES.

12. THE ARGUMENT THAT THERE MAY BE UNDERINVESTMENT IN
REFINING CAPACITY IS WITHOUT MERIT. NONE OF THE
PROPOSALS PUT FORWARD BY AGRICULTURE INVOLVE A SUPPORT
PRICE FOR REFINED SUGAR BUT FOR RAW SUGAR. THERE IS
LITTLE MERIT IN THE ARGUMENT THAT BEET AND CANE
PROCESSING PLANT AND EQUIPMENT MIGHT BE INADEQUATE
AFTER A PERIOD OF LOW PRICES. SURELY, THESE ARE LONGER
TERM INVESTMENTS THAT ARE NOT MADE ON THE BASIS OF YEAR
TO YEAR PRICE FLUCTUATIONS.

13. IN ADDITION TO THE EFFECTS ON THE PRICE OF SUGAR,

A PUBLIC POLICY DECISION TO SUPPORT THE PRICE OF SUGAR
WITH QUOTAS OR TARIFFS OPENS UP THE POSSIBILITY OF PRICE
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SUPPORTS FOR A RANGE OF OTHER COMMODITIES, DOMESTICALLY AND INTERNATIONALLY. IT ALSO UNDERMINES OUR POSITION REGARDING DEVELOPING COUNTRY PRODUCERS OF RAW MATERIALS WHO ARGUE FOR INTERNATIONAL COMMODITY AGREEMENTS TO RAISE PRICES OF GOODS THEY PRODUCE. OUR POSITION IS THAT COMMODITY AGREEMENTS SHOULD BE PRIMARILY ORIENTED TOWARD PRICE STABILIZATION, AND RELY PRIMARILY ON BUFFER STOCKS, NOT ON QUOTAS AND CONTROLS THAT RAISE PRICES ABOVE EQUILIBRIUM LEVELS.

14. THE CONSUMER MAY BE AFFECTED IF A TARIFF IS USED TO RAISE PRICES RATHER THAN A QUOTA. IT HAS BEEN ARGUED AT THE EPG THAT QUOTAS ARE PREFERABLE TO TARIFFS BECAUSE TARIFFS TEND NOT TO RAISE THE DOMESTIC PRICE SO MUCH AS LOWER THE INTERNATIONAL PRICE. THIS ARGUMENT IS HARD TO SUSTAIN SINCE A QUOTA HAS VIRTUALLY THE SAME EFFECT. THE ELASTICITY OF U.S. IMPORT DEMAND AND SUPPLY DETERMINES HOW MUCH EFFECT THERE IS ON DOMESTIC PRICE AND HOW MUCH ON THE INTERNATIONAL PRICE--REGARDLESS OF WHETHER A TARIFF OR A QUOTA IS IMPOSED.

15. THE CONSUMER IS AFFECTED BY THE CHOICE OF QUOTA OR TARIFF, HOWEVER, TO THE EXTENT OF THE EFFECT ON FEDERAL BUDGET REVENUES AND EXPENDITURES. A TARIFF AUTOMATICALLY ADDS TO GOVERNMENT REVENUES. A QUOTA ADDS GOVERNMENT REVENUES ONLY IF ACCOMPANIED BY AUCTIONS OF IMPORT QUOTAS, OR A VARIABLE LEVY TO CONFISCATE THE SCARCITY RENTS ASSOCIATED WITH IMPORT QUOTAS. QUOTAS, ESPECIALLY IF THEY CUT VERY DEEPLY INTO IMPORT QUANTITIES, MAY BE DIFFICULT AND COSTLY TO ADMINISTER AND THUS RAISE GOVERNMENT EXPENDITURES.

16. FOR EACH CENT THAT A TARIFF OR QUOTA RAISES THE DOMESTIC U.S. PRICE, GOVERNMENT REVENUES COULD BE 75 MILLION DOLS (?). THESE INCREASED REVENUES COULD BE CONSTRUED AS A BENEFIT TO CONSUMERS. THESE BENEFITS, CONFIDENTIAL

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HOWEVER, WOULD HAVE TO BE OFFSET BY THE COSTS OF ADMINISTERING QUOTAS.

17. A DEFICIENCY PAYMENT SCHEME WOULD HAVE VIRTUALLY NO PRICE EFFECTS ON CONSUMERS AND WOULD NOT GENERATE THE MARKET INEFFICIENCIES CHARACTERISTIC OF TARIFFS OR QUOTAS. THE MAJOR COST OF DEFICIENCY PAYMENTS TO CONSUMERS WOULD BE THROUGH AN INCREASE IN GOVERNMENT EXPENDITURES, ABOUT 125 MILLION DOLS TO COMPENSATE FOR EVERY ONE CENT IN THE PRICE OF SUGAR, OR 375 MILLION

DOLS TO COMPENSATE FOR THREE CENTS.

18. INSTEAD OF TARIFFS OR QUOTAS, THE U.S. GOVERNMENT COULD UNDERWRITE, SAY THROUGH CCC LOANS, A BUILDUP OF SUGAR INVENTORIES TO REMOVE SOME SUGAR OFF THE MARKET. THIS WOULD NOT BE INEFFICIENT IF STORAGE COSTS, PLUS INTEREST COSTS, WERE COVERED BY FUTURE SALES AT HIGHER PRICES. THE CONSUMER WOULD PAY HIGHER PRICES NOW BUT WOULD BENEFIT FROM LOWER PRICES LATER WHEN EXCESS STOCKS WERE SOLD OFF.

19. ONE ARGUMENT AGAINST SUGAR STOCKS IS THAT SUGAR IS COSTLY TO STORE AND HAS ONLY ABOUT A 12 MONTH SHELF LIFE. THUS SPOILAGE WOULD RESULT IF ANY MORE THAN 12 MONTHS OF STOCKS WERE HELD AT ANY ONE TIME. IF, HOWEVER, THE DOMESTIC PRICE OF SUGAR WERE RAISED BY TARIFFS OR QUOTAS, STOCKS WOULD TEND TO BE BUILT UP ANYWAY SINCE DOMESTIC PRODUCTION WOULD BE STIMULATED AND DEMAND DEPRESSED. CURRENT WORLD STOCKS ARE ABOUT 3 MONTHS CONSUMPTION AND, WHILE VERY HIGH HISTORICALLY, MIGHT BE EXPANDED WITHOUT SPOILAGE PROBLEMS.

20. ANOTHER ARGUMENT AGAINST GOVERNMENT ENCOURAGEMENT OF STOCK PURCHASES IS THAT THE POLICY WOULD TEND TO INCREASE IMPORTS. THUS A STOCKING POLICY IS BEST PURSUED
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IN THE CONTEXT OF AN INTERNATIONAL AGREEMENT TO SHARE THE BURDEN OF HOLDING STOCKS.

21. THE BUDGETARY COST OF A STOCKING SCHEME DEPENDS ON THE TECHNIQUES USED. DIRECT GOVERNMENT PURCHASES MIGHT REQUIRE (BLANK) FOR EACH ONE CENT PER POUND EFFECT ON PRICES. GOVERNMENT LOANS ON FAVORABLE TERMS MIGHT HAVE NO BUDGETARY IMPACT, DEPENDING ON WHICH LOAN MECHANISMS WERE USED.

22. CLEARLY, FROM THE CONSUMER PERSPECTIVE, A DEFICIENCY PAYMENT SCHEME, ADJUSTMENT ASSISTANCE, OR A GOVERNMENT STOCKING POLICY WOULD BE LESS COSTLY. A STOCKING SCHEME THAT WAS PROFITABLE AND STABILIZED PRICES COULD EVEN PROVIDE NET BENEFITS TO THE CONSUMER.
END TEXT.

23. COMMENT: THIS IS A VERY ROUGH FIRST DRAFT AND NEEDS TO BE SUPPORTED BY MORE QUANTITATIVE ANALYSIS. JOAN AND I THOUGHT, HOWEVER, IT WOULD BE USEFUL TO GET YOUR COMMENTS AT AN EARLY STAGE SINCE THERE IS SO LITTLE TIME.
VANCE

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